Statement No. 66 of the Governmental Accounting Standards Board

Technical Corrections—2012

an amendment of GASB Statements No. 10 and No. 62
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Summary

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, and No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.

This Statement amends Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, by removing the provision that limits fund-based reporting of an entity’s risk financing activities to the general fund and the internal service fund type. As a result, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement 54 and Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments.

This Statement also amends Statement 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, Accounting for Operating Leases with Scheduled Rent Increases, and result in guidance that is consistent with the requirements in Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues, respectively.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

How the Changes in This Statement Improve Financial Reporting

The requirements of this Statement resolve conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting and thereby enhance the usefulness of the financial reports.
Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 2 discusses the applicability of this Statement.
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an amendment of GASB Statements No. 10 and No. 62

March 2012

Governmental Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116
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March 2012

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Technical Corrections—2012

an amendment of GASB Statements No. 10 and No. 62

March 2012

INTRODUCTION

1. The objective of this Statement is to improve accounting and financial reporting by state and local governmental entities by resolving conflicting guidance that resulted from the issuance of two pronouncements—Statements No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, and No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. Since the release of these Statements, questions have arisen concerning differences between the provisions in Statement 54 and Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, regarding the reporting of risk financing activities. Questions also have arisen about differences between Statement 62 and Statements No. 13, Accounting for Operating Leases with Scheduled Rent Increases, regarding the reporting of certain operating lease transactions, and No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues, concerning the reporting of the acquisition of a loan or a group of loans and the recognition of servicing fees related to mortgage loans that are sold.
STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

2. This Statement supersedes paragraph 63 of Statement 10 and paragraphs 222 and 460, including footnote 218, of Statement 62. It also amends paragraphs 227 and 442 of Statement 62 and paragraphs 52, 64, and 76 of Statement 10. This Statement applies to accounting and financial reporting by state and local governmental entities, including public entity risk pools.

Amendments to Statement 10—Use of Special Revenue Funds to Report Risk Financing Activities

3. Paragraph 63 of Statement 10 requires that an entity’s risk financing activities be accounted for in either the general fund or an internal service fund, if a single fund is used. That paragraph is deleted in its entirety, with the exception of footnote 12, to remove the provision that limits fund-based reporting of an entity’s risk financing activities to the general fund and the internal service fund type. Footnote 12 is retained to clarify the reference to internal service funds in paragraph 65 of Statement 10. In addition, paragraph 52 of Statement 10 is amended by deleting the sentence that refers to paragraph 63, and paragraphs 64 and 76 are amended to replace references to the general fund with references to governmental funds.

Amendments to Statement 62—Operating Leases

4. Paragraphs 222 and 227b of Statement 62 include guidance on accounting for operating lease payments that vary from a straight-line basis. Those provisions are deleted to remove what could be perceived as a potential prohibition against the use of the fair value method that is permitted in paragraph 6b of Statement 13.
Amendments to Statement 62—Purchase of a Loan or Group of Loans

5. Paragraph 442 of Statement 62 includes guidance on accounting for the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans. The purchase of a loan or group of loans should be reported at its purchase price. Paragraph 442 of Statement 62 is amended to delete the last three sentences and retain the first sentence as follows:

The initial investment in a purchased loan or group of loans should include the amount paid to the seller plus any fees paid or less any fees received.

Amendments to Statement 62—Servicing Fees

6. Paragraph 460 of Statement 62 includes guidance on recognition by a transferor for servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. That paragraph is deleted in its entirety, including footnote 218, to remove the provision that the sales price should be adjusted, for purposes of determining any gain or loss on the sale, to provide for the recognition of a normal servicing fee in each subsequent year. That requirement conflicts with the provisions in paragraph 13 of Statement 48 that require a gain or loss to be recognized without such an adjustment to the sales price.

EFFECTIVE DATE AND TRANSITION

7. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Early application is encouraged. In the first period that this Statement is applied, changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be restated. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning net
position (or fund balance or fund net position, as appropriate) for the earliest period restated (generally the current period). In the first period that this Statement is applied, the financial statements should disclose the nature of the restatement and its effect.

The provisions of this Statement need not be applied to immaterial items.

This Statement was issued by unanimous vote of the seven members of the Governmental Accounting Standards Board.

Robert H. Attmore, Chairman
William W. Fish
Michael H. Granof
David E. Sundstrom
Jan I. Sylvis
Marcia L. Taylor
James M. Williams
Appendix A

BACKGROUND

8. Statement 10, issued in November 1989, provides accounting and financial reporting guidance for risk financing and insurance-related activities of state and local governmental entities. Paragraph 63 of Statement 10 requires that if a single fund is used to account for an entity’s risk financing activities, that fund should be either the general fund or an internal service fund.

9. Statement 54, issued in February 2009, enhances the usefulness of fund balance information by clarifying the existing governmental fund type definitions. The definition of and criteria for a special revenue fund in paragraphs 30 and 31 of Statement 54 would allow for certain risk financing activities to be reported in a special revenue fund; however, the guidance in paragraph 63 of Statement 10 was not superseded.

10. Statement 13, issued in May 1990, provides accounting and financial reporting guidance for governments that enter into operating leases with scheduled rent increases. Paragraphs 6(a) and 6(b) of Statement 13 specifically allow the lessor government to recognize operating lease payments on a straight-line basis over the lease term or based on the estimated fair value of the rental.

11. Statement 48, issued in September 2006, provides accounting and financial reporting guidance for governments that exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments. Paragraph 13 of Statement 48 requires that the transferee government recognize the receivables acquired at the purchase price and that the transferor recognize a gain or loss on the difference between the proceeds and the carrying value of the receivables sold.

12. Statement 62, issued in December 2010, incorporates into the GASB’s authoritative literature certain accounting and financial reporting guidance that was included in Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants pronouncements issued on or before November 30, 1989. The guidance on reporting operating lease payments that originated from FASB Statement No. 13, Accounting for Leases, issued in November 1976, the guidance on reporting the purchase of a loan or group of loans that originated from FASB Statement No. 91, Accounting for Nonrefund-
able Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, issued in December 1986, and the guidance on reporting service fees that originated from FASB Statement No. 65, Accounting for Certain Mortgage Banking Activities, was incorporated into the GASB authoritative literature with the issuance of Statement 62.

13. Statement 62 provides guidance on accounting for (a) operating lease payments that vary from a straight-line basis, (b) the difference between the initial investment (purchase price) and the principal amount (face value) of a purchased loan or group of loans (a receivable), and (c) servicing fees that relate to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. However, that guidance was not amended to conform with the requirements in paragraph 6(b) of Statement 13 and paragraph 13 of Statement 48, respectively.

14. In June 2011, the risk financing reporting issue was introduced to the Governmental Accounting Standards Advisory Council (GASAC). The GASAC members recognized the reporting issues associated with this item and the need to address it.

15. At its August 2011 meeting, the Board considered GASAC members’ input and the potential adverse effect on the consistency of financial reporting posed by the conflicting guidance. A project on technical corrections was then added to the current agenda.

16. In October 2011, the Board issued an Exposure Draft, Technical Corrections. Nineteen organizations and individuals responded to the Exposure Draft by submitting comment letters. Those responses contributed to the Board’s deliberations in finalizing the requirements of this Statement.
Appendix B

BASIS FOR CONCLUSIONS

17. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board’s reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

Scope and Applicability of This Statement

18. Questions raised through technical inquiries received by the GASB highlighted what the Board considers conflicting accounting and financial reporting guidance issues. Given the nature of the current authoritative guidance, these issues cannot be resolved through an Interpretation, Technical Bulletin, or question and answer in the Comprehensive Implementation Guide. Accordingly, the scope of this project was established to develop a Statement amending Statements 10 and 62. This Statement addresses the conflicting accounting and financial reporting guidance that resulted from the issuance of Statements 54 and 62. Respondents to the Exposure Draft generally were in agreement with the amendments.

Amendments to Statement 10—Use of Funds to Report Risk Financing Activities

19. The Board recognizes that a single fund that meets the special revenue fund criteria in Statement 54 could be used to account for an entity’s risk financing activities. For example, some state statutes authorize their local governments to assess a dedicated tax levy for tort liabilities, which would constitute a restricted revenue that could serve as the foundation for reporting a special revenue fund. This dedicated tax levy is an example of a constraint placed on the use of resources that is externally imposed by laws or regulations of other governments (state statute). As a result, the Board concluded that it is not appropriate to limit single-fund reporting of risk financing activities to the general fund and the internal service fund type, as is currently required by Statement 10.
20. The Board considered three alternatives that would address the conflicting guidance within Statements 10 and 54: (a) amending Statement 10, paragraph 63, to specifically include the special revenue fund type as a potential alternative to report an entity's risk financing activities; (b) amending Statement 10 by deleting paragraph 63 to remove the limitation to the general fund and the internal service fund type; and (c) amending Statement 54 to incorporate the provision in Statement 10, paragraph 63.

21. The Board believes that it generally is not appropriate to prescribe which governmental fund type should be used in standards addressing specific individual activities or transactions, such as risk financing (alternative a). Rather, the Board concluded that the governmental fund type definitions provided in Statement 54, generally, should be used as the basis for making these fund type determinations.

22. The Board also concluded that there is no compelling reason to prohibit the use of a special revenue fund to account for risk financing activities (alternative c). Paragraph 119 of the Basis for Conclusions of Statement 10 discusses the perceived benefit of being able to easily review and evaluate the risk financing function when all related activities are isolated in one dedicated fund. However, risk financing activities generally are not presented as a single line in the financial statements of the general fund. Therefore, in practice, the goal of presenting risk financing information so that it can be easily reviewed and evaluated cannot be achieved when it is presented in the general fund. The Board concluded that this goal generally could be achieved, however, if risk financing activities that meet the definition of a special revenue fund were reported in a separate special revenue fund.

23. For the aforementioned reasons, the Board concluded that it was most appropriate to remove the guidance creating the implied prohibition against using a special revenue fund to account for an entity's risk financing activities (alternative b). As a result, governments should base their fund type decision on the nature of the activity to be reported.

**Amendments to Statement 62—Operating Leases**

24. Statement 13 provides that when the payment requirements of an operating lease with scheduled rent increases include a rental payment in one or more years that is artificially low when viewed in the context of earlier or later payment requirements (rent reduction or “rent holiday”), payments received
from the operating lease should be accounted for based on either (a) the estimated fair value of the rental payments or (b) a straight-line basis over the lease term. In these cases, part of the scheduled increased rental payments compensates the lessor for not receiving fair rental payments in the early periods of the operating lease. Consequently, part of the later rental payments should be considered as payment of the principal of the financing and part as interest. (Similar rent reductions in the middle or later periods of the operating lease also may be a method of financing and should be accounted for similarly.) Certain rent reductions or rent holidays may be inducements designed to provide an incentive for the lessee to enter into an operating lease, and these lower rental payments are not based on economic factors relating to the property. In these cases, Statement 13 provided that the accounting should not be based on the contract terms. Although the Board initially preferred using fair value to account for operating leases in this situation, it was persuaded by respondents to the Exposure Draft of Statement 13 to allow the straight-line alternative in addition to the estimated fair value of the rental payments. Therefore, Statement 13 included a provision that a straight-line recognition approach should be available as a practical and cost-beneficial alternative to the fair value method.

25. By contrast, paragraphs 222 and 227b of Statement 62 state that if rental payments vary from a straight-line basis, the revenue should be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which the benefit is derived from the leased property. These provisions led some to believe that the application of the fair value method was prohibited.

26. The Board considered two alternatives to address the differences in the guidance within Statements 13 and 62: (a) amending Statement 62 to exclude the guidance that differs from Statement 13 and (b) amending Statement 13 to be consistent with Statement 62. The Board believes that professional judgment should be used to determine whether rental payments are based on economic factors relating to the property or, instead, are an inducement to the lessee. Statement 13 provides for both measurement approaches addressed in paragraphs 222 and 227b of Statement 62—paragraph 5b in Statement 13 addresses payments that are more representative of the time pattern of use, and paragraph 6a provides the straight-line alternative. The Board is not aware of any compelling reason why the fair value option in paragraph 6b of State-
Amendments to Statement 62—Purchase of a Loan or a Group of Loans

27. The Board believes that transactions involving certain financial instruments (accounts receivable and loans receivable) should be accounted for in a similar manner. While loans generally have stated interest rates and receivables do not, the Board found no compelling reason why the acquisition of such financial assets should be reported differently. The conflict in guidance arose in September 2006 with the issuance of Statement 48, which differed from the pre-November 30, 1989 FASB guidance (FASB Statement 91).

28. The Board considered two alternatives to address the conflicting guidance within Statements 48 and 62: (a) amending Statement 62 to exclude the conflicting guidance and (b) amending Statement 48 to be consistent with Statement 62. The Board concluded that the purchase of a loan or groups of loans should be reported at acquisition cost because that is the government's initial investment. Therefore, the Board concluded that it would be more appropriate to amend Statement 62 (alternative a).

29. A respondent to the Exposure Draft recommended including the future effects on interest earnings recognizing the premium or discount associated with current lending rates. In considering this view, the Board noted that governments generally are sellers of receivables or loans, rather than acquirers. Governments generally do not acquire loans or receivables with the intention of servicing and collecting those loans or receivables. Rather, governments that make loans often sell them to provide resources to make additional loans. However, some state agencies acquire groups of delinquent tax liens receivable from local governments and do so at significant discounts. Therefore, the Board concluded that the provisions in Statement 48 for a government acquirer to recognize the receivables or loans acquired at their acquisition cost is a practical approach for those situations in which a government acquires receivables from another government to provide liquidity for the selling government.
Amendments to Statement 62—Servicing Fees

30. A respondent to the Exposure Draft identified an apparent conflict between the requirements in paragraph 460 of Statement 62 and paragraph 13 of Statement 48. The Board reviewed the guidance in those two Statements and agreed that there was a conflict. The Board concluded that because paragraph 460 of Statement 62 conflicts with Statement 48, the guidance provided in paragraph 460 should not have been included in that Statement. The Board discussed the existence and significance of servicing fee arrangements in the governmental environment during the deliberations of Statement 48 and concluded then that governments should not be required to assess retained service fees but, instead, should recognize servicing fees as stipulated in the transfer agreement as revenue when earned, that is, as the servicing takes place.

31. The Board considered two alternatives to address the conflicting guidance within Statements 48 and 62: (a) amending Statement 48 to be consistent with Statement 62 and (b) amending Statement 62 to exclude the guidance that conflicts with Statement 48. The Board reaffirmed the conclusion in Statement 48 and found no compelling reason to amend that Statement to require an adjustment of the sales price for gains or losses from servicing fees. Therefore, the Board concluded that it would be more appropriate to amend Statement 62. Paragraph 460 of Statement 62 should have been excluded from the standard originally because of its conflict with the existing requirements in Statement 48.

32. The requirement in paragraph 460 of Statement 62 derives from paragraph 11 of FASB Statement 65. That Statement was superseded by FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, which was then superseded by FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement 125. The relevant provisions in that Statement were subsequently amended by FASB Statement No. 166, Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140. As a result of those amendments, the private-sector guidance that is currently applicable is not comparable to the requirements in Statement 62, paragraph 460.
Effective Date

33. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. The Exposure Draft proposed an effective date that was 18 months earlier. The Board believes that delaying the effective date is appropriate so that it remains consistent with the effective date of Statement No. 65, Items Previously Reported as Assets and Liabilities, which amends the lending activities provisions of Statement 62. The Board also was concerned with the number of pronouncements that potentially would have become effective for financial statements for periods beginning after June 15, 2012. The Board also notes that governments are encouraged to early implement this Statement.
Appendix C

CODIFICATION INSTRUCTIONS

34. The section that follows updates the June 30, 2011, Codification of Governmental Accounting and Financial Reporting Standards, for the effects of this Statement.

* * *

CLAIMS AND JUDGMENTS SECTION C50

.109 [Replace the last two sentences with the following:] The accounting in governmental funds or an internal service fund is discussed in paragraphs .126–.131. [GASBS 10, ¶52, as amended by GASBS 34, ¶6 and GASBS 66, ¶3]

.124 [Delete the third sentence; move footnote 8 to the end of paragraph .127.] [GASBS 34, ¶92 and ¶107; GASBI 6, ¶14]

.126 [In the first, third, and last sentences and in the heading, replace the general fund with a governmental fund.] [GASBS 10, ¶64, as amended by GASBS 66, ¶3; GASBS 34, ¶79 and ¶112]

.144 [In the second sentence, replace the general fund with a governmental fund and delete reference to paragraph .124.] [GASBS 10, ¶76, as amended by GASBS 66, ¶3]

* * *

PUBLIC ENTITY RISK POOLS SECTION Po20

.110 [In the last sentence, replace the general fund with a governmental fund.] [GASBS 10, ¶11; GASBS 10, ¶76, as amended by GASBS 66, ¶3]

* * *
35. The section that follows updates the Codification Instructions of Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, for the effects of this Statement. The requirements of Statement 62 are effective for periods beginning after December 15, 2011.

* * *

LEASES SECTION L20

[Delete paragraph .121, including heading; renumber subsequent paragraphs.]


.134 [Insert paragraph .105, including footnote, from the June 30, 2010, Codification of Governmental Accounting and Financial Reporting Standards.]

* * *

LENDING ACTIVITIES SECTION L30

[Delete paragraph .129, including heading and footnote; renumber subsequent paragraphs and footnotes.] [Delete paragraph .503; renumber subsequent paragraphs.]

* * *

36. The section that follows updates the Codification Instructions of Statement No. 65, Items Previously Reported as Assets and Liabilities, for the effects of this Statement. The requirements of Statement 65 are effective for periods beginning after December 15, 2012.

* * *

LENDING ACTIVITIES SECTION L30

Sources: [Add the following:] GASB Statement 66

.113 [Delete the second, third, and fourth sentences.] [GASBS 62, ¶442, as amended by GASBS 65, ¶24 and GASBS 66, ¶5; GASBS 65, ¶24; GASBS 66, ¶5]

* * *